



DEFENSE CONTRACT AUDIT AGENCY
DEPARTMENT OF DEFENSE
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IN REPLY REFER TO

PAC 730.3.B.01/2007-02

January 18, 2007
07-PAC-002(R)

MEMORANDUM FOR REGIONAL DIRECTORS, DCAA
DIRECTOR, FIELD DETACHMENT, DCAA

SUBJECT: Audit Alert on the Evaluation of Directly Associated Unallowable Costs

This audit alert emphasizes the importance for auditors to ensure that directly associated unallowable costs have been excluded from claimed costs or questioned when auditing contractor incurred cost proposals. FAR 31.201-6 defines "Directly associated cost" as "any cost that is generated solely as a result of incurring another cost, and that would not have been incurred had the other cost not been incurred."

The standard incurred cost audit programs for both major and non-major contractors include steps for auditors to determine whether the contractor has appropriately excluded directly associated unallowable costs from the incurred cost claim. For example, a contractor may have a facility located in the Washington, DC area where its primary function is to perform lobbying activities. The contractor has appropriately excluded salaries for employees performing lobbying activities from its incurred cost claim, as they are unallowable in accordance with FAR 31.205-22, *Lobbying and political activity costs*. The auditor must ensure that the contractor has also excluded all directly associated costs, which in this example may include travel expenses, support staff labor, and facilities costs.

To ensure that all directly associated unallowable costs have been excluded from the indirect cost claim or questioned, auditors should perform, at a minimum, the following actions:

- Perform a comparative analysis of voluntary deletions to prior years' voluntary deletions to identify areas (e.g., significant increased/decreased amounts, obvious omissions, new categories of voluntary deletions, etc.) which require follow-up audit procedures,
- Analyze voluntary deletions to determine whether the contractor has identified and excluded directly associated unallowable costs in accordance with FAR 31.201-6, and
- Review all questioned costs to determine whether the contractor incurred any directly associated costs that should be questioned and removed from the indirect cost pool in accordance with FAR 31.201-6(d) and (e).

If FAO personnel have any questions, they should contact regional personnel. Regional personnel with any questions should contact Accounting and Cost Principles Division, at (703) 767 3250.

/Signed/
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Assistant Director
Policy and Plans

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